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Arbitration and Appraisal: Rent Reset Issues

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ABSTRACT

Commercial leases often contain arbitration clauses to address disputes between a landlord and tenant. One of the most common disputes arbitrated centers on the determination of market rent or rent as defined or described in the lease, when the parties are unable to reach agreement through negotiation. Often the arbitration clause in the lease will dictate that an appraiser possessing certain professional qualifications and experience is to be selected and mutually appointed or party-appointed if an arbitral panel is contemplated. A determination of the rent to be fixed by the arbitrator or arbitral panel either during the term of the lease or at the end of the lease pursuant to an option to extend or renew the lease often requires evidence from real estate professionals, which typically include valuators. An appraiser appropriately qualified to act as an arbitrator, coupled with an effective appraisal strategy, should reduce the time required to complete the arbitration, and result in cost savings to both parties. Depending on the jurisdiction in which the property is located, the complexity of the valuation issue(s) or the amount of rent in dispute, it may be appropriate for each party to have its own appraisal report independently reviewed by a qualified appraiser prior to the arbitration. This article explores the decision to arbitrate and some of the issues encountered through the presentation of case studies, the role of an appraiser as an arbitrator, and the expectations of an appraiser acting as an expert witness.

Keywords: Arbitration; Rent; Rent reset; Lease; Landlord; Tenant

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1. INTRODUCTION

Many long term commercial leases (Sevelka, 2020), whether of land or space,[1] contain an arbitration clause as a court-alternative mechanism to resolve disputes between a landlord (lessor) and a tenant (lessee) in a consensual, confidential and private forum. One of the most common disputes concerns resetting of rent either at some point during the term of the lease, or at the end of the existing term by an option to extend the term of the existing lease or by exercising a renewal option. If the parties fail to negotiate a new rent within a specified timeframe as dictated by the lease, one of the parties will trigger the arbitration clause calling either for appointment of one mutually agreed arbitrator or for each party to designate a party-appointed arbitrator, the two of whom will, in turn, select a head (neutral) arbitrator or chair, rounding out the arbitral panel. Appointing real estate appraisers with appropriate professional designations, knowledge and skills as arbitrators to resolve rent reset disputes, and presenting them with appraisal evidence that is thorough and credible[2] should reduce the time to complete arbitrations, and result in substantial cost savings to the parties of the dispute.

This article explores some of the criteria by which appraisers are selected to act as arbitrators, and the importance of appraisers acting as expert witnesses to present evidence that is consistent with the nature of the dispute, and in compliance with recognized appraisal theory and practice. Unique situations involving space lease disputes and the potential consequences of failing to adhere to the arbitration clause or the agreement to arbitrate mutually agreed upon by the parties to the dispute are also addressed.

2. DEFINITION OF ARBITRATION

Arbitration involves resolution of disputes outside the courts, wherein the parties to a dispute refer it to one or more persons, by whose decision (the "award") they agree to be bound. Arbitration is a form of binding dispute resolution, similar to litigation, and entirely distinct from the various forms of non-binding dispute resolutions, such as negotiation and mediation, although it is possible to enter into binding mediation (Thayer and Smith, 2012).[3] As described by the American Bar Association,

> "Arbitration is a private process where disputing parties agree that one or several individuals can make a decision about the dispute after receiving evidence and hearing arguments. The arbitration process is similar to a trial in that the parties make opening statements and present evidence to the arbitrator."

Compared to a traditional trial, arbitration allows for appointment of subject matter experts as decision makers, is less formal and can usually be completed more quickly.

3. ARBITRATION AWARD

An Arbitration Award (or Arbitral Award) resolves a matter in dispute in a private forum. At the conclusion of an arbitration hearing, the arbitrator or arbitral panel issues an *Award*, which is a determination on the merits (i.e., the decision), and is analogous to a judgment in a court of law. Depending on the jurisdiction in which the property is located or the terms of the arbitration agreement, the award is issued to the parties either in a "conclusory"[4] manner or "reasoned" (Chalk, 2019) setting out in transparent and sufficient detail (Kirchner, 2014) the basis of the decision.

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[1] A "lease" is defined as "a contract in which the rights to use and occupy land, space, or structures are transferred by the owner to another for a specified period of time in return for a specified rent," p. 105, *Dictionary of Real Estate Appraisal*, 7th ed., © 2022, Appraisal Institute.

[2] *Uniform Standards of Professional Appraisal Practice* (USPAP define "credible" as "worthy of belief)." Appraisal Institute's *Standards of Valuation Practice* (SVP), effective November 12, 2021, define "credible" as "worthy of belief, supported by analysis of relevant information. Credibility is always measured in the context of intended use.

[3] See *Bowers v. Raymond J. Lucia Companies, Inc.*, 206 Cal. App. 4th 724 (2012) 142 Cal. Rptr. 3d 64. Retrieved from https://casetext.com/case/bowers-v-raymond-j-lucia-cos

[4] Consisting of or relating to a conclusion or assertion for which no supporting evidence is offered. Retrieved from https://dictionary.findlaw.com/definition/conclusory.html

4. BRIEF LITERATURE REVIEW

In 1987, the American Arbitration Association published *Arbitration of Real Estate Valuation Disputes*,[5] which was funded by a grant from the American Institute of Real Estate Appraisers, a predecessor organization of the Appraisal Institute. The text includes a collection of papers authored by a number of prominent appraisers and lawyers who were engaged in the arbitration of valuation disputes of real property rights and describes the procedural steps and obligations of an arbitrator, and discusses the role of an independent expert. The stated objective of the text is described as follows:

> "It is hoped that the reader will become oriented to the arbitration process in general and to its specific application to real estate disputes in particular. Although a number of the authors make reference to legal issues and decisions, this volume is not intended to be an authoritative legal treatise. Different precedents and main trends exist in different state jurisdictions. Furthermore, there may be conflicting precedents within the same jurisdiction."

While the appraisal profession in North America has a long history of involvement in resolving real estate disputes, the topic of arbitration appears for the first time in the 15th edition of the Appraisal Institute's *The Appraisal of Real Estate* published in 2020 in which the word "arbitration" appears three times. In November 2016 (later revised in 2020), the Appraisal Institute published Guide Note 16 *Arbitration*,[6] accompanied by a press release referencing Advisory Opinion 21 of Uniform Standards of Professional Appraisal Practice (USPAP),[7] which explains the purpose of arbitration, and the role and professional obligations of a Member of the Appraisal Institute acting either as an expert witness or as an arbitrator, usually to resolve a dispute involving market value or market rent, or value or rent as defined/described in the lease.

The Appraisal Institute in broadening an understanding of arbitration as a means of resolving valuation disputes undertook a number of initiatives. Following three initiatives occurred that have raised awareness and understanding of arbitration as an area of expertise within the valuation profession:

- Publication of Appraisers in Arbitration (Konikoff, 2018, followed by second edition, 2022);
- Inclusion of a brief reference to arbitration in the 15th edition (2020) of *The Appraisal of Real Estate* as a subcategory of consulting (p. 648);
- Development of Course "Expand Your Practice: Arbitration Do's and Don'ts."

The text, *Appraisers in Arbitration*, delves into areas of appraisal practice beyond those typically associated with valuation practice. Alternative dispute resolution (ADR), which includes negotiation, mediation and arbitration (Celik, 2013), presents a growing area of need for the skills of valuation professionals. *The Appraisers in Arbitration*, second edition, provides detailed information to help valuation professionals participate in arbitration and understand the roles they will play. The text provides specific advice on how to perform each task required of an arbitrator, expert witness, or consultant and the standards that apply to each service. Every step in the arbitration process, from the preliminary hearing to the final award, is explained and common arbitration scenarios and real-world examples are discussed.

5. APPRAISER AS ARBITRATOR

The qualifications for selecting an arbitrator in a rent reset dispute are dictated by the language of the lease or as agreed upon by the parties to the dispute. If an appraiser is appointed to act as an arbitrator in a rental dispute, that particular individual is typically expected to possess a requisite professional designation, and the skills and experience to understand and resolve the dispute. Complex rent resets involving ground leases (Sevelka, 2011) demand a higher level of knowledge and expertise than is necessary to address a rent reset of a single tenancy in a small storefront. However, in all rent reset disputes the real estate appraiser appointed as an arbitrator should possess experience with the

[5] *Arbitration of Real Estate Valuation Disputes*, American Arbitration Association, New York. 1987.
[6] Guide Note 16, *Arbitration*, revised November 2020, https://www.appraisalinstitute.org/assets/1/7/guide-note- 16.pdf.
[7] Appraisal Institute's New Guidance Outlines Appraiser's Role in Arbitration, *Real Estate Rama*, January 27, 2017. https://www.realestaterama.com/appraisal-institutes-new-guidance-outlines-appraisers-role-in-arbitration-ID040185.html [retrieved on 4 December 2023].

property type and have experience reading commercial leases and understanding relevant lease clauses. A lease is a contract, and the interpretation of the rent reset clause is of critical importance to the parties in a rent reset dispute.[8] Appraisers may possess the same professional designations, but can have vastly different skills and experiences. An appraiser's suitability to act as an arbitrator depends on the language of the arbitration clause or as agreed upon by the parties, and may speak to some of the following:

- Professional Appraisal or Appraisal Review Qualifications (e.g., MAI, AACI, FRICS, AI-GRS[9])
- Continuing Professional Education (on-going professional development)
- Professional Contributions (e.g., relevant articles published in recognized journals or trade publications)
- Appraisal Experience
- Ethical Requirements (whether the appraiser has been disciplined by any governing appraisal body for ethical breaches)
- Reputation within the Appraisal Community
- Geographic Knowledge of the area where the property (demised premises) is located (Carneghi, 1999).

In virtually all jurisdictions, the decision of an arbitrator or arbitral panel is final and binding, so it is extremely important for a real estate appraiser when acting as an arbitrator to understand his/her legal duties to the parties. Short of fraud, evident partiality[10] or a failure on the part of the arbitrator to adhere to the parties' arbitration agreement or to the provisions of the relevant arbitration act in conducting the arbitration, it is virtually impossible to vacate an arbitration award.[11] Public policy supports minimal judicial intervention in an arbitration award, and the parties do not get to appeal an adverse decision[12] unless the arbitrator or arbitration panel has exceeded its jurisdiction[13] or authority.[14] Parties who opt for arbitration to settle their disputes accept up-front the risk of errors in *law* or *fact* committed by the arbitrator or arbitration panel.[15, 16]

No matter how harsh,[17] unfair, or unreasonable the terms and conditions of a lease are to either party, absent any ambiguity,[18] courts will not intervene and rewrite a lease to which the terms and

[8] Contract interpretation might require the assistance of legal counsel.
[9] The AACI designation is awarded by the Appraisal Institute of Canada, and the FRICS designation is awarded by the Royal Institution of Chartered Surveyors in United Kingdom, both with similar designation requirements to the MAI granted by the Appraisal Institute in United States. The AI-GRS is a "General Review Specialist" designation awarded by the Appraisal Institute to professionals who provide reviews of appraisals of a wide range of property types, including commercial, industrial, agricultural, residential and vacant land. For designation requirements, see the link https://www.appraisalinstitute.org/why-join/pursue-a-designation/ai-grs-designation.
[10] On December 30, 2019, the Ninth Circuit Court of Appeals denied petitions for panel rehearing and rehearing en banc in *Monster Energy Co. v. City Beverages, LLC*, No. 17-55813, and confirmed its decision to vacate an arbitration award for failure to disclose that (1) the arbitrator was a co-owner of JAMS (Judicial Arbitration and Mediation Services, Inc.); and (2) the prevailing party (Monster Energy Co.) had several prior cases with JAMS. The Ninth Circuit reversed and vacated the arbitration award for "evident partiality" resulting from the arbitrator's failure to disclose an ownership interest in JAMS, even though he stated to the parties that he "has an economic interest in the overall financial success of JAM."
[11] In the United States, grounds for setting aside an award are set out in the Federal Arbitration Act (FAA): "(1) where the award was procured by corruption, fraud, or undue means; (2) where there was evident partiality or corruption in the arbitrators, or either of them; (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made (9 U.S. Code § 10(a)."
[12] "Courts have repeatedly instructed litigants that challenges to the arbitrator's rulings on discovery, admission of evidence, reasoning, and conduct of the proceedings do not lie." *Evans v. Cornerstone Development Co.*, 35 Cal. Rptr. 3d 745 (2005) 134 Cal.App.4th 151.
[13] In *Westnav Container Services v. Freeport Properties Ltd.*, 2010 BCCA 33, the arbitrator's award made an error in describing the rental rate for a comparable property and, in supplementary reasons, the arbitrator eliminated reference to that comparable and added reference to other comparables, leaving the result unchanged. The Court of Appeal, at para. 47, found that the arbitrator had exceeded his jurisdiction and committed arbitral error.
[14] In *Bankers Life & Casualty Insurance Co. v. CBRE, Inc.*, 830 F.3d 729, (2016), the Court of Appeals, 7th Circuit, held that the arbitration panel exceeded its authority by basing its award on documents outside the parties' agreement, unilaterally inserted by CBRE.
[15] As established by the US Supreme Court in *Oxford Health Plans v. Sutter*, 133 S. Ct. 2064 (2013), 569 U.S. 564, 186 L. Ed. 2d 113, "[t]he potential for…mistakes is the price of agreeing to arbitration" and "so far as the arbitrator's decision concerns construction of the contract, the courts have no business overruling him because their interpretation is different from his."
[16] In Canada, in *Sattva Capital Corp. v. Creston Moly Corp.*2014, SCC 53, the Supreme Court of Canada limited the availability of appeals from commercial arbitration awards on questions of law to those "rare" cases where the arbitral tribunal has made an "extricable error of law." *Pre-publication Article: Arbitration Appeals on Questions of Law in Canada: Stop Extricating the Extricable!*, https://arbitrationmatters.com/news/pre-publication-article-arbitration-appeals-on-questions-of-law-in-canada-stop-extricating-the-inextricable/ retrieved on 4 December 2023.
[17] *Heller & Henretig v. 3620-168th St., Inc.*, 302 N.Y. 326 (1951); *Hartigan v. Casualty Co. of America*, 227 N.Y. 175 (N.Y. 1919).

conditions were voluntarily and mutually agreed by the lessor and lessee, and drafted by experienced legal counsel. Rent reset clauses are the product of negotiation either directly by the parties to the lease (contract) or indirectly through legal counsel, and each rent reset clause is uniquely tailored to meet the specific business interests of each party, and the way in which parties contract to have rent *reset* is entirely within their discretion. The fact that a contract term is imprudent for one party to have agreed upon or that it worked out badly or even disastrously is no reason to deviate from the clear language of a rent reset clause. Whether a rent reset clause favours the landlord or the tenant is an irrelevant factor in fixing the new rent. Arbitration, unlike mediation,[19] is not intended to produce a "win-win" outcome for both parties, which can sometimes lead a disgruntled party confronted by an unfavourable award to sue its own valuation expert in those jurisdictions that do not recognize witness immunity.[20] However, an appraiser acting as an arbitrator is entitled to arbitral immunity, which is defined and explained as follows:

> "Arbitral immunity refers to the immunity that is extended to arbitrators for acts arising out of the scope of their arbitral functions. Arbitrators are judges chosen by the parties to decide the matters submitted to them. The independence necessary for principled and fearless decision making can best be preserved by protecting these persons from bias or intimidation caused by the fear of a lawsuit arising out of the exercise of official functions within their jurisdiction. Arbitral immunity is the keystone of the arbitral system and should not be overturned. Arbitral immunity is necessary for finality of arbitrators' decisions."[21]

6. CONDUCTING AN ARBITRATION

Once appointed, an arbitrator or arbitral panel performs a number of duties, and arbitral decisions on issues that are within the arbitrator's jurisdiction are given substantial deference by the courts. In a rent reset arbitration proceeding, the arbitrator or arbitral panel should:

- Obtain a copy of the executed lease, including amendments to the lease, and a statement of the issue(s) in dispute (e.g., property value, rental value) from each party.
- Read the lease thoroughly, including schedules and any amendments to the lease, well in advance of the actual arbitration.
- Request a mutually agreed-upon Statement of Facts from the parties to narrow the scope of the dispute and minimize the duration and cost of the arbitration.
- Not engage in *ex parte* communications, as this conduct is a ground supporting vacatur of an arbitral award.[22]
- Arrange a preliminary conference call, remote hearing or in-person hearing with the parties to discuss pre-arbitral issues and arbitral procedural issues and rules set forth by the arbitrator for the hearing. The arbitrator and the parties should agree on basic procedural issues, such as schedule, length and location of hearing(s), the number of expert witnesses, and the amount of time each party will have to present its case.
- Conduct the arbitration on the basis of a formal hearing, written submissions, teleconference or video conference (visual and audio), or a combination thereof. Consider the complexity of the issue(s) in dispute, while adhering to the principles of a fair arbitration process.[23] The COVID-19 global pandemic, announced March 11, 2020, which restricted public gatherings, has resulted in a paradigm shift reducing or eliminating the need for in-person hearings, and

[18] *Ruth v. A.Z.B. Corp.*, 2 Misc.2d 631, 636 [NY County], *affd* 2A.D/2d 970 [1st Dept 1956]. Case cited in *The Manufacturers Life Insurance Company v. Parc-IX Limited*, 2018 ONSC 3625.
[19] *Black's Law Dictionary*, 11th edition, defines "mediation" as "[a] method of nonbinding dispute resolution involving a neutral third Party who tries to help the disputing parties reach a mutually agreeable solution."
[20] In *Marrogi v. Howard*, 805 So. 2d 1118 – La: Supreme Court 2002, para. 1129, and corresponding footnote 16. In *Estate of Voutsaras v. Bender*, Mich: Court of Appeals 2019, the court ruled that "[l]icensed professionals owe the same duty to the party for whom they testify as they would to any client, and witness immunity is not a defense against professional malpractice."
[21] USLegal, https://definitions.uslegal.com/a/arbitral-immunity/
[22] The United States Court of Appeals for the Sixth Circuit held that ex parte communications void an award if they violate the parties' arbitration agreement. In *Star Ins. Co. v. Nat'l Union Fire Ins. Co. of Pittsburgh*, PA, No. 15- 1403, 2016 BL 267734 (6th Cir. Aug. 18, 2016),
[23] In *1414 Holdings, LLC v. BMS-PSO, LLC*, 2017 NY Slip Op 32551(U), the New York Supreme Court upheld a neutral arbitrator's decision to not undertake a formal hearing, and confin[e] "the scope of the assignment..[to] meeting with [the parties'] arbitrators, reviewing all submitted documents and evidence, inspecting the subject premises, confirming the appropriateness of the data assumption and analyses presented by the arbitrators, and reaching a decision as to the value of the 19th Floor Space [at 1414 Avenue of the Americas in New York]." There is no express requirement in the lease for a formal hearing.

now post-pandemic most arbitrations are conducted online resulting in substantial cost savings to the parties.

- Issue, if necessary, a subpoena requiring a non-party to produce documents and/or attend and give evidence at an arbitration hearing. However, seeking documents and/or testimony from non-party witnesses is a complicated legal process in some jurisdictions, and if the subpoena is resisted, it may cause unnecessary delay of the arbitration. In some rental disputes, before the actual hearing commences, it may be appropriate for the arbitrator to order the appraisers retained by the parties to meet in private (without prejudice) to seek consensus on issues bearing on the determination of rent and submit a joint statement to that effect, which should be of assistance to the arbitrator and possibly lead to settlement between the parties.
- Exercise discretion over the admissibility of evidence as to its relevance and necessity, and guard against tactics that are inconsistent with the principle of fundamental fairness (Blankley, 2014).[24]
- Inspect the subject premises, when it is appropriate and practical to do so or when authorized by the parties.
- Inspect the comparables, when it is appropriate and practical to do so or when authorized by the parties.[25]
- Rule on *motions* submitted by the parties during the arbitration.
- Enter an *award* upon agreed terms at the request of the parties if the parties reach a settlement during the arbitration. Conversely, the parties may agree to discontinue the arbitration and enter into a private contract spelling out the terms and conditions of the settlement.
- Issue a written, dated, and signed decision (Arbitration Award),[26] including the legal place of the arbitration, and refrain from attaching any professional designations to the signature.[27]
- Issue a written and signed Cost Award in favour of the prevailing party, if mandated, following the completion of the arbitration.

7. CHARACTERISTICS OF A LEASE RENEWAL AND LEASE EXTENSION

A resetting of rent during the term of an existing space lease (i.e., part or all of a building) always takes into consideration the lease itself, and typically all of the subsisting terms remain intact in fixing the new rent. The same holds true when resetting rent for a stated term under an *option to extend* [28] an existing lease. An *option to renew* constitutes a new lease, and resetting of the rent for the term covered by the renewal option may or may not take into account the subsisting terms of the original lease. There is a technical distinction between a [lease] *renewal* and [lease] *extension*. An extension is a stretching or spreading out of the term of the lease. A renewal, on the other hand, creates a new and distinct tenancy and is not merely a perpetuation of the old tenancy. It contemplates the execution of a new lease document.[29]

In *Fire Productions Ltd. v. Lauro*,[30] the British Columbia appellate court addressed the interpretation of the term "fair market rent" in the renewal clause of the lease:

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[24] In *1552 Broadway Retail Owner LLC v. McDonald's*, 2017 NY Slip Op 50011(U) [Jan 9, 2017], the New York Supreme Court upheld the Arbitration Award, while "find[ing] the behavior of Tenant's counsel and expert reprehensible, especially in light of the Tenant's previous protestations that the parties having different understandings of FMV would cause the arbitration to be 'fatally flawed.'" [Footnote 9]

[25] In *California Union Square LP v. Saks & Co., LLC*, 50 Cal.App.5th 340 (2020), the arbitration agreement gave the arbitrator discretion to inspect "the subject property" and "the party experts' lease comparables," but the trial court determined that the arbitrator exceeded his powers by visiting properties outside the scope of his authority as arbitrator.

[26] In most jurisdictions in the United States reasons for an arbitration Award are not required, but the parties may still request a reasoned Award.

[27] A state-licensed appraiser acting as an arbitrator in Hawaii is subject to Hawaii Revised Statutes Section 466K-6, and "the record of an award shall include but not be limited to findings of fact, the…rationale for the award,…certification of compliance with the most current Uniform Standards of Professional Appraisal Practice…; and information regarding the evidence, including the data, methodologies, and analysis that provided the basis for the award." This requirement is unique to the state of Hawaii.

[28] According to *The Dictionary of Real Estate Appraisal*, 7th ed., an option to extend a lease is synonymous with the term "renewal option," defined as "an agreement entered into at the time of the original lease providing the tenant with the right, but not the obligation, for the tenant to extend the lease term for a specified time at a rent specified in the option agreement or at the market rate at the time of renewal."

[29] See 10 Miller & Starr, Cal. Real Estate (4th ed. 2020). Landlord and Tenant, 'Renewal' and 'extension' distinguished §34.73 (Miller & Starr)

[30] *Fire Productions Ltd. V. Laura*, 2006 BCCA 497 (CanLII), <http://canlii.ca/t/1q1r7>, accessed on 22 November 2023.

> "… provided that the rental payable under the [renewal] of the lease will be the fair market rent for the Premises as mutually agreed upon by the parties hereto within one (1) month after the giving of such notice, provided that upon failure of such agreement, the same will be determined by a single arbitrator acting in accordance with the Commercial Arbitration Act (British Columbia), whose decision will be binding on the parties hereto."

The tenant exercised a second *renewal* option for a term of 5 years commencing May 1, 2003. The dispute was whether the tenant's leasehold improvements should be considered in the rent reset analysis upon "renewal" of the lease. The court treated the renewal option as if the premises were available for lease in "as is" condition (i.e., as finished space) on the open market to any potential third party, commenting as follows:

> "The tenant has not been disadvantaged if on exercising his right of renewal he is required to pay the rent the landlord would be able to obtain if the lease was not renewed. The tenant may in one sense be paying interest on the improvements he made, but he has the continued use of the improvements, which have become the property of the landlord, to the end of the renewal period. It is all a matter of the bargain driven when the parties enter into the lease and it is then essential that effect be given to the wording the parties actually employed to express their bargain in any given instance. In this case, the bargain made in terms of the renewal rent to be paid favoured the landlord."

8. NATURE OF RENT TO BE DETERMINED

In exchange for the right of a tenant to occupy and use space on specified terms and conditions, a landlord is entitled to receive *rent*. The nature of the *rent* to be determined for the demised premises (or leased space) is defined and dictated by the language of the lease, and may deviate from Market Rent, which, according to *The Dictionary of Real Estate Appraisal*, 7th edition, is defined as follows:

> "The most probable rent that a property should bring in a competitive and open market under all conditions requisite to a fair lease transaction, the lessee and lessor each acting prudently and knowledgeably, and assuming the rent is not affected by undue stimulus."

Implicit in this definition is the execution of a lease as of a specified date under conditions whereby:

- Lessee and lessor are typically motivated;
- Both parties are well informed or well advised, and acting in what they consider their best interests;
- Payment is made in terms of cash or in terms of financial arrangements comparable thereto; and
- The rent reflects specified terms and conditions found in that market, such as permitted uses, use restrictions, expense obligations, duration, concessions, rental adjustments and revaluations, renewal and purchase options, frequency of payments (annual, monthly, etc.), and tenant improvements (TIs) [p. 117].

9. EXISTING USE OR (UNRESTRICTED) HIGHEST AND BEST USE

A *use clause* in a space lease dictates the type of use(s) to which the demised premises can be put during the term of the lease or during the period of a lease extension. However, the formula or mechanism for resetting the rent during the term of the lease or during the period of a lease extension may have no connection to what is actually permitted under the use clause. Unless the language of the lease has a contrary intention, the appraiser should estimate rent on the basis of the use(s) permitted under the use clause in the existing lease.

If a rent reset clause in a space lease stipulates that market rent be based on the highest and best use[31] of the space (demised premises), all relevant factors, including the following, should be taken into account by the appraiser as of the valuation date stipulated in the lease:

[31] "Highest and best use" is "The reasonably probable use of property that results in the highest value [and] [t]he four criteria that…must be met are legal permissibility, physical possibility, financial feasibility, and maximum productivity," *The Dictionary of Real Estate Appraisal*, 7th ed., p. 88. For a discussion of "Highest and Best Use" involving ground leases see "Ground Leases: Rent Reset Valuation Issues," The Appraisal Journal, (Fall 2011), p. 316-317.

- The years remaining on the existing lease[32] and any lease extensions unilaterally exercisable by the lessee (tenant) at the time of the rent reset or the period of time stipulated in the rent reset clause.[33]
- The location of the space within the building or complex.
- The type of access to the space (e.g. stairs, elevator, street grade, etc.).
- The amount of space and its utility.
- The condition of the space (i.e., finished or unfinished).
- The age and condition of the building or complex housing the space.
- The uses permitted under the prevailing land use controls, and not prohibited by any restrictive covenants registered against title or by covenants in other tenant leases.
- The market support and level of demand for each permitted (viable) use.

A space lease (demised premises) that makes no provision for parking (either onsite or offsite) eliminates permitted uses dependent on parking, and permitted uses that cannot be accommodated within the space or within the unexpired term of the lease and any lease extensions are also eliminated from further consideration. Likewise, any permitted use that is not financially feasible given the remaining term of the lease, coupled with any lease extensions, is also eliminated from further consideration in the highest and best use analysis.

In *McDonald's Corporation v. 1552 Broadway Retail Owner, LLC*,[34] a dispute arose as to whether resetting of the rent during the first 5 years of a 10-year Lease Extension[35] should be based on the existing restaurant use or the (unrestricted) highest and best use of the "demised premises" defined as follows:

> "The demised premises consist of a ground floor space [2,200 square feet], basement [315 square feet] and mezzanine [3,700 square feet]..."

The fixing of rent for the 5-year period of June 1, 2014 to May 31, 2019 is pursuant to the following formula as set out in valuation clause 4(b)(1):

> "Ninety Percent (90%) of the fair market rent (the "FMV") for the demised premises determined as of the date occurring six (6) months prior to June 1, 2014 [the "*Determination Date*"]….The FMV shall be determined on the basis of the highest and best use of the demised premises and considering all relevant factors."[36]

According to Article 9 of the lease, the only permitted use of the demised premises is as a McDonald's restaurant or another restaurant that McDonald's operates. The *use* clause is in conflict with the rent reset (valuation) clause, and to suggest restaurant use is the only permitted use of the demised premises would render the valuation clause and the concept of highest and best use meaningless. At the tenant's insistence, the court was persuaded to intervene on a threshold issue of "highest and best use," arguing that the arbitration would be impracticable if the parties' competing valuations were premised on different concepts of value. '*Highest and best use*' is not a term typically found in rent reset clauses associated with space leases in a building. Also, reference in the rent reset clause to *fair market rent* as *FMV* is confusing on its face, as *FMR* is the common initialism for *fair market rent*. A poorly drafted rent reset clause can make it difficult for an appraiser to determine appropriate uses of the demised premises, define the type of value and apply appropriate appraisal methods and techniques, and a challenge for an arbitrator to interpret.

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[32] An early termination clause exercisable at the discretion of the owner (landlord) effectively reduces the remaining term of the lease for the purpose of a rent reset, and has an impact on highest and best use analysis, resulting in a lower rent for the rent reset period. To achieve a higher rent, it is in the best interest of the owner (landlord) to waive the early termination clause for the purpose of resetting the rent for the period covered by the rent reset.

[33] In *Galvano Enterprises Limited v. Orionvink BV*, [1999] NICA 11, at each rent reset date of the 25-year Term of the space lease rent is to be fixed "for a term equal to, whichever is the greater of, the period of 15 years or the remainder of the Term."

[34] *McDonald's Corporation v. 1552 Broadway Retail Owner, LLC*, 2017 NY Slip Op 50011(U) – NY: Supreme Court, 2017, https://static.schlamstone.com/docs/1552-Broadway-Retail-Owner-LLC-v-McDonalds-Corporation-2017-NY-Slip-Op-50011U.pdf accessed on 11 November 2023.

[35] Pursuant to the Lease, the rent in Years 6-10 is to be 115% of the rent fixed during Years 1-5 of the 10-Year Lease Extension.

[36] Highest and best use in the context of estimating market rent of a *space* lease should consider reasonably probable uses permitted under the prevailing land use controls supported by an investment horizon or holding period of 10 years, consistent with the term of the lease extension and lease expiry, as of the valuation or rent reset date stipulated in the lease. In other words, prospective retail/commercial tenants requiring more than 10 years recouping their investment in the business and leasehold improvements should be disregarded in the highest and best use analysis. Certainly, the remaining term of the lease, i.e., the 10-year lease extension and lease expiry of May 31, 2024, is a "relevant factor" in the highest and best use analysis.

As noted by the court, "highest and best use" is a phrase used all the time in the real estate industry. Determining highest and best use is within the jurisdiction of the arbitrators (unless the use is stipulated in the lease or agreed to by the parties). However, the court ruled that the arbitrators could not limit their valuation analysis to the use of the demised premises as a *McDonald's* restaurant without determining if there are more valuable uses for the demised premises pursuant to the language of the rent reset clause.

'Highest and best use' analysis can prove challenging in a rent reset of a leasehold defined only as part of a building or complex and with a fixed term under single tenant occupancy. *McDonald's* space lease, with a remaining term of 10 years,[37] consists of 5,900 square feet on two levels, street frontage of 37.75 feet (midblock location), and benefits from exposure to pedestrian and vehicular traffic (high volume in Times Square). The potential proxy tenant pool for the space occupied by *McDonald's* is limited, as space requirements vary from tenant to tenant depending on the nature of the business and intended use.

10. APPRAISAL SUGGESTIONS AND CONTENT

A lease that calls for the exchange of appraisal reports by a specified date requires each party give its appraiser sufficient lead time to complete the appraisal in a credible and timely manner. Conversely, it is equally important that an appraiser retained on behalf of a party involved in a rental dispute be aware of and comply with contractual obligations involving compliance with recognized appraisal principles and standards such as Uniform Standards of Professional Appraisal Practice (USPAP), Canadian Uniform Standards of Professional Appraisal Practice (CUSPAP) or International Valuation Standards (IVS),[38] and timely completion and delivery of an appraisal report. If the appraisal is to be independently reviewed (Sevelka, 1996 &1997; Sorenson, 2010),[39] more lead time should be set aside to commission the appraisal. A lease clause or provision that imposes unrealistic timeframes for the preparation and exchange of appraisal reports should, if possible, be renegotiated or temporarily relaxed for the mutual benefit of the parties before proceeding to arbitration.

Credible appraisal evidence is crucial in a rent reset dispute, and each party (or their legal counsel) should exercise due diligence in overseeing the appraisal process to provide for the following:

- The appraiser's overriding duty is to assist the trier of fact (i.e. arbitrator, arbitral panel or court) and to provide evidence that is objective and non-partisan, and a statement to that effect should be attached to the appraisal report.
- The appraisal report must identify the intended user, the intended use (i.e., arbitration), type of value (e.g., market value, market rental value) and sourced definitions, effective date of opinions and conclusions, and any assignment conditions.[40]
- The appraisal report should include a detailed curriculum vitae disclosing professional qualifications, emphasizing knowledge and experience relevant to the valuation issue(s) in dispute.
- The appraisal report should include a "Lease Synopsis," with an executed copy of the Lease attached to the appraisal report.
- The appraisal report should include date-stamped aerial views and street scenes to provide the arbitrator or arbitral panel with a geographic context for the subject property (demised premises).
- The *Scope of Work*[41] undertaken and presented in the appraisal must be consistent with the intended use, outlining the nature and extent of the research conducted in connection with

[37] In *United Equities, Inc. V. Mardordic Co.*, 8 AD 2d 398 (1st Dept. 1959), *affd* 7 N.Y. 2d 911 (1960), the court ruled that consideration must be given to the term of the rent reset (21 years) and the renewal option (21 years), or 42 years in total, in determining "the best use to which the land can be put and not limited to improvement as a garage," para. 405. With rent fixed for only 21 years, redevelopment options may be impacted by mortgage financing constraints.

[38] In *Westnay Container Services Ltd. V. Freeport Properties Ltd.*, 2009 BCSC 184 (CanLII), the arbitrator rejected a two-step procedure (i.e., estimated property value times estimated rate of return) in favour of an estimated lease rate applied directly to the demised premises in resetting the rent. The rationale for resorting to indirect methods of estimating rent should be adequately explained in the appraisal report.

[39] Appraisal Review requirements are covered under Standard 3 and Reporting Standard 4 of USPAP; Standards Rule 10 and 11, and Reporting Standards 6 and 7 of CUSPAP; and Section 6 under Professional Standard 2 of the RICS Valuation – Global Standards, effective January 31, 2022.

[40] See "Identification of the Appraisal Problem," *The Appraisal of Real Estate*, 15th ed., p. 30.

[41] CUSPAP (effective January 1, 2024) 3.72 defines *Scope of Work* as "[t]he type of Inspection, the type and extent of research and analysis required, any limitations, or other terms to fulfill the Authorized Assignment. The Scope of Work for an Assignment is determined by the Member's compliance to CUSPAP and applicable legislation. [see 6.2.4, 7.5, 7.6]

the rent reset assignment, and reliance on reports prepared by other professionals must be disclosed. The appraisal report should be proofread for typographical errors, math errors, factual omissions, inconsistent statements and inclusion of privileged documents or information inadmissible in a court of law such as protected client-lawyer communications or work product.[42]

- The appraisal report should be independently reviewed before reports are exchanged, and prior to submitting the report to the arbitrator or arbitral panel. If necessary, the appraisal report should be amended to shore up any weaknesses and reconcile inconsistencies, and correct errors of commission or omission, all to ensure compliance with professional appraisal standards,[43] and applicable legal requirements.
- The appraisal report should include sketches (or architectural drawings, if available) and confirmed measurements of the demised premises[44] or premises in dispute if not explicitly defined in the lease or agreed to by the parties. It is preferable for the parties to jointly retain a qualified third-party to conduct measurements of demised premises in dispute prior to commencing the arbitration. If the demised premises include improvements or structures, a building permit history and analysis should be provided, if readily available.
- Ideally, the appraisal report should include an abstract of title or parcel register for each comparable sale or comparable lease relied on in the rent reset analysis.
- The appraisal should disclose and analyze recent leasing activity or listings of the subject and all of the comparable market data relied on in the rent reset analysis extending for a period of time prior to the effective date of the rent reset considered appropriate by the appraiser.
- The appraisal should disclose the address or legal description of each comparable lease/rental and the extent of documentation and verification of each comparable lease/rental relied on in the rent reset analysis.
- The appraisal should disclose whether and when a sale or lease/rental comparable has been inspected, and, ideally, by whom. All photographs and aerial views should be date-stamped.
- The reliance on published surveys (e.g., land prices, rental rates, rates of return, etc.) should reflect an understanding as to how they were conducted, for what purpose and by whom.
- The reliance on any *assignment conditions*[45] must not limit the scope of work to such a degree that the assignment results are not credible in the context of the intended use, and the assignment conditions must be disclosed in the appraisal report.
- The appraisal methods and techniques relied on must be appropriate and properly applied, consistent with the intended use of the appraisal, and reflect the current body of appraisal knowledge.[46]

11. CASE STUDY – REVIEW OF A RENT RESET ARBITRATION AWARD

In a rent reset involving a landlord and *Best Buy Canada Ltd.* as the lessee (tenant), the dispute was confined to determining "market rent" of a space lease for 5 years, consisting of a 37,000-sf store (occupied by Best Buy) on two levels (17,385 sq. ft. – 1st floor, and 19,598 sq. ft. - 2nd floor) and 109 surface parking spaces, argued before a "single" arbitrator:

> "Fixed Rent for the sixteenth (16th) through twentieth (20th) Lease Years [June 1, 2014 – May 31, 2019] (i.e., the second option period) shall equal the greater of (i)…$1,095,030.00 per

[42] The rules of privilege are matters of public policy that are to be enforced in arbitration just as they would be in litigation, p. 4; "Best Practices Regarding Evidence in Arbitrations," *American College of Trial Lawyers, Alternative Dispute Resolution Committee*, February 2018. Retrieved from https://www.actl.com/docs/default-source/alternative-dispute-resolution-committee/adr_best_practices_regarding_evidence_in_arbitrations.pdf?sfvrsn=2.
[43] Compliance with CUSPAP, USPAP or IVS, depending on the laws in the jurisdiction in which the property is located, and, if a member of a professional organization, compliance with their rules and regulations.
[44] *Demised premises* are defined as "[p]roperty that is leased to a person or entity for s specific period of time…," *The Dictionary of Real Estate Appraisal*, 7th ed. (Chicago: Appraisal Institute, 2022), 51.
[45] USPAP defines Assignment Conditions as "assumptions, extraordinary assumptions, hypothetical conditions, laws and regulations, jurisdictional exceptions, and other conditions that affect the scope of work. Laws include constitutions, legislative and court-made law, administrative rules, and ordinances. Regulations include rules or orders, having legal force, issued by an administrative agency."
[46] References to outdated appraisal texts should be avoided. Quoting from outdated appraisal texts may be a sign of indifference to the profession expanding its body of knowledge or his or her own knowledge, especially if the appraiser's curriculum vitae fails to demonstrate the knowledge and experience necessary to complete an assignment for its intended use.

annum; or (ii) the market rental value for the Premises but excluding from consideration, the Tenant's signs, trade fixtures, furnishings and interior finishes. Should the Landlord and Tenant not be able to agree on the market rental value in respect of the Premises, the issue shall be arbitrated in accordance with the *Arbitration Act* (Ontario)."

"In the event of any bona fide dispute arising between Tenant and Landlord under this Lease, the dispute, at the option of Landlord or Tenant will immediately be referred to a single arbitrator to be agreed upon by Tenant and Landlord….Such arbitrator, whether agreed on or appointed, will have access to such records of the parties as are reasonably necessary and the decision of such arbitrator will be final and binding upon the parties. The cost of the arbitration will follow the award, unless otherwise determined by the arbitrator."

At the outset of the arbitration, the Landlord's appraisal estimated the annual market rental value at $1,653,140, while the Tenant's appraisal estimated the annual market rental value as a range of $662,771 to $983,232, with both appraisers relying on comparable lease/rental data. Subsequent settlement offers made by each party were rejected. The divergence in the parties' market rental value estimates is an astonishing 68% to 150%. A brief review of the arbitrator's award, which in this rental dispute required a reasoned award,[47] reveals the following:

- "Sales volumes,"[48] a fundamental metric of a "big box"[49] retail operation, and the typical parking ratio required to support a retail operation[50] are not mentioned in the arbitral award, but it is unknown whether this information was contained in either party's appraisal report.
- One of the appraisals treated the store and parking as two discrete components, contrary to the language of the lease,[51] to derive a market rental rate for the Premises (consisting of the property as a whole), an approach which is inconsistent with recognized appraisal theory.
- In the presentation of comparable lease/rental data, the reported per square foot rates are "net", but it is unknown whether either party's appraisal report included a cost of occupancy analysis[52] to account for differences in operating expenses between the subject Premises and each comparable lease/rental.
- As for the corresponding parking ratios of the comparables, it is unknown whether that information was provided in either party's appraisal report.
- Although the arbitrator accepted that the "amended use provision [in the Lease] is broad enough to encompass a wide variety of uses," there is no reference in the decision as to the

[47] Under the Commercial Arbitration Rules of the American Arbitration Association (CAR-46(b)), '[t]he arbitrator need not render a reasoned award unless the parties request an award in writing prior to appointment of the arbitrator or unless the arbitrator determines a reasoned award is appropriate." According to JAMS Comprehensive Arbitration Rules & Procedures, effective June 1, 2021, Rule 24 (h), "[t]he Award shall consist of a written statement signed by the Arbitrator regarding the disposition of each claim and the relief, if any, as to each claim. Unless all Parties agree otherwise, the Award shall also contain a concise written statement for the Award."

[48] In 2009, at the time of the previous rent reset, the Best Buy Brand averaged sales of $877 per sq. ft. based on 1,023 stores and an average store size of 39,000 sq. ft. In 2014, Best Buy's average store size was 27,400 sq. ft., and sales volume averaged $770 per sq. ft. based on 1,779 stores, https://retail-index.emarketer.com/company/data/5374f24e4d4afd2bb4446640/5374f25d4d4afd824cc1564d/lfy/false/best- buy-real-estate [accessed 27 November 2023]. According to CBRE's July 13, 2015 *Marketflash* (Money Talks: Retail Sales Productivity Show Divergence in Performance), Best Buy Co. Inc.'s (Future Shop, Best Buy, Best Buy Mobile) sales productivity in Canada averaged $800 per sq. ft. in 2013.

[49] "A single-use store, typically between 10,000 and 100,000 square feet or more, such as a large bookstore, office-supply store, pet store, electronics store, or toy store (ICSC)" *Dictionary of Real Estate*, 7th ed. p. 18. The typical lease term for a "Big Box" store is 20 years, often structured as an initial term of 10 years at fixed rental rates with two 5-year lease extensions or options to renew, also at fixed rental rates.

[50] A typical parking ratio for a "big box" retailer is between 4.5 and 5.5 stalls per 1,000 sq. ft. of Gross Leaseable Area (GLA). The subject Premises has a parking ratio of 2.87 stalls per 1,000 sq. ft. of GLA, which may be appropriate given that the store is located in a densely populated urban area on a subway line in midtown Toronto, Ontario.

[51] The parking component is operated by a third party on behalf of the tenant under a License Agreement with the tenant. A "license" is not an interest in land, and *The Dictionary of Real Estate*, 7th ed., defines "license" as "[f]or real property, a personal, unassignable, and typically revocable privilege or permit to perform some activity on the land of another without obtaining an interest in the property." [p. 108] In *12400 Stowe Drive, LP v. Cycle Express, LLC*, Cal: Court of Appeals, 4th Appellate District, Division One, the "Premises" consist of a 133,125 sq. ft. industrial building on a 297,505 sq. ft. site and an adjoining 112,830 sq. ft. vacant lot used for customer parking during auctions, as no off-site parking is permitted. In resetting the rent for the 5-year lease extension, the court found in favor of the tenant's appraisal, which estimated the market rental value of the two components as one "collective unit" at $106,500 per month, based on the conditions and restrictions contained in the Lease. The landlord's appraisal valued each component separately in its highest and best use and arrived at a combined market rental value of $138,270 per month.

[52] Tenants are concerned about *Occupancy Cost*, which "…constitute the rent and reimbursables (expense reimbursements to the landlord as specified in the lease), which may include items such as heat, utilities, janitor service, taxes not included in the rent, and amortization of the tenant's cost of alterations over the term of the lease." *The Dictionary of Real Estate*, 7th ed., p. 134.

zoning of the subject property (Premises) and the Permitted Uses. It is unknown whether either party's appraisal report contains a zoning analysis of the demised Premises.

- There is no indication which, if any, of the *uses* reflected in the comparable lease/rental data would be permitted in, or suitable for the subject Premises (37,000 square feet over two levels), and available for the 5 years remaining on the term of the Lease. It is unknown whether this information is contained in either party's appraisal report.
- Only one of the rental comparables (an available sublease) presented in one of the party's appraisal report is for a term of 5 years, consistent with the 5-year period for which the rent was to be fixed, and is on two levels (13,400 sq. ft. – 1st floor, and 14,500 sq. ft. – 2nd floor), as is the subject space, but it was dismissed by the arbitrator as "not an accurate reflection of the market."

There may be no reasonable basis for the large divergence in the opinions of market rental value, and why the arbitration should have taken "some ten days" to complete is not entirely clear. Neither party's opinion of market rental value was accepted by the arbitrator, who fixed the rent for the Premises at $1,279,260. Based on the entirety of the evidence presented by the parties, the arbitrator identified the Landlord as "the prevailing party," leaving the Tenant to bear the cost of the arbitration, including the Landlord's Costs Award of $383,000. On appeal, the Tenant argued unsuccessfully against the Costs Award claiming that the Awarded Rent of $1,279,260 was closer to the minimum "Base Rent" of $1,095,030 than the Landlord's settlement Offer of $1,550,000. As noted by the court,

> "The Arbitrator was entitled to exercise his discretion in weighing the relevant factors he considered in making the Costs Award."

The arbitration lasted 10 days at an approximate cost of $1,000,000. Both parties would likely have benefited had each party undertaken an independent review of their own appraisal prior to relying on it for the purpose of the rent reset arbitration, assuming no such review was undertaken.

Ensuring an appraisal report has addressed the disputed rent reset valuations issue(s) in a thorough and credible manner should be of assistance to each party in understanding the relative merits and strength of its case and assist the arbitrator or arbitral panel in deciding the dispute, and reduce the cost of the arbitration to both parties. Arbitrators make decisions on the basis of the appraisal evidence presented to them, and the decisions they make are guided by the completeness, accuracy, adequacy, relevance and reasonableness of the appraisal reports.

12. ARBITRATOR REJECTS NON-COMPLIANT APPRAISAL REPORT

Presenting appraisal evidence that falls short of the professional standards expected of a "reasonable appraiser"[53] and that does not follow "applicable appraisal principles" can cause a party to sustain significant financial losses, and, in turn, could have unintended consequences for an appraiser whose client has received an unfavourable decision in an arbitration as occurred in the dispute between two parties over the value of an unserviced 84-acre parcel to be developed some six to eight years in the future as a residential subdivision.[54]

A retired judge presided over an 18-day hearing as the sole arbitrator, and based on a very detailed analysis referencing an authoritative appraisal text and generally accepted appraisal standards he rejected the appraisal prepared on behalf of one of the parties. In effect, one party was left without any appraisal evidence on which to rely in support of its position. The reasoning in support of the arbitrator's decision to reject the appraisal is reproduced, in part, as follows:

> "In his analysis, [the] Arbitrator…imported and, with rigour, applied a number of professional standards from the Canadian Uniform Standards of Professional Appraisal Practice [CUSPAP] and the text *The Appraisal of Real Estate, 3rd Edition, Canadian Edition*, published by the Appraisal Institute of Canada [AIC]. He reasoned that the latter part of Article 9 [of the Co-Tenancy Agreement] was intended to make the AIC Standards and principles in its text applicable to the appraisals called for under the CTA.[55]

[53] CUSPAP 3.64 defines "Reasonable Appraiser" as "[a] Member providing Professional Services within an acceptable standard of care and based on rational assumptions. [see 4.2.5, 7.1.2, 9.9]
[54] On the facts of the case, the arbitrator concluded that the Subdivision Development Approach had no application.
[55] Under the CTA, the appraisals had to be prepared by designated "AACI" members of the Appraisal Institute of Canada.

> …[T]he…Report did not qualify as an appraisal under Article 9 of the CTA [Co-Tenancy Agreement]; on the evidence there was no factual basis for estimating the value of the land using the appraisal method [Land Residual Approach] chosen by…[the appraiser]; and, there were errors in the inputs and/or calculations…[the appraiser] had made, as reflected in the detailed reasons given between pages 15 and 40 of his decision.
>
> …[The] Arbitrator examined the "Land Residual Approach" said by…[the appraiser] to have been used to determine the fair market value[56] of the subject property. This approach was described in the AIC text as one technique of giving effect to the income approach. In contradiction, notes the Arbitrator, the income approach was said by the appraisal not to be relevant. He rejected…[the appraiser's] insistence that the Land Residual Approach was the same as the Subdivision Development Approach, as being inconsistent with the authoritative text….In comparing…[the appraiser's] report and evidence to specific A.I.C. standards, [the] Arbitrator said they "… did not begin to comply"."

The arbitrator informed himself as to the body of knowledge articulated in *The Appraisal of Real Estate*, and the *Canadian Uniform Standards of Professional Appraisal Practice* (CUSPAP), standards to which all members of the Appraisal Institute of Canada must comply.

It is apparent that the "Land Residual Approach" is not the same as the "Subdivision Development Approach,"[57] and one is not a substitute for the other. The financial losses sustained by the party left without an acceptable appraisal, including a reported $800,000 payment of costs levied by the arbitrator, could possibly have been avoided had the appraisal report been independently reviewed prior to the arbitration, assuming no such review was undertaken. The party's trust in the appraisal proved fatal. In some jurisdictions, an appraiser retained as an expert witness may be liable for negligence in his or her report or testimony,[58] and could be held liable if the retainer agreement (contract) with the client is breached and results in financial losses. The appraiser's work product might also lead to an investigation by the umbrella organization of which the appraiser is a Member. Of course, before an assignment is accepted an appraiser has an obligation to satisfy the competency provision as set out in CUSPAP, USPAP or IVS, depending on the governing Standards. [59]

13. CONCLUSION

Arbitration may be preferable to court proceedings as a mechanism to resolve disputes over private contracts such as leases, especially valuation issues involving rent resets. While still adversarial, arbitration is a consensual and typically less formal procedure, and resolution of a dispute is timely. Arbitrators experienced as valuators understand the appraisal process and the governing appraisal standards (e.g., USPAP, CUSPAP, IVS), making appraisers suitably qualified to act as arbitrators in rent reset disputes. An arbitrator whose rent reset decision rests on appraisal evidence has an expectation of being able to rely on credible appraisals, as does each party on whose behalf the appraisal has been prepared.

An arbitrator retained for their subject matter expertise should be capable of identifying both the strengths and weaknesses of each party's appraisal evidence, while performing the arbitral duties in a

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[56] *The Dictionary of Real Estate*, 6th ed., 2015, defines "*fair market value,* in nontechnical usage, a term that is equivalent to the contemporary usage of *market value.*" The 7th ed., 2022, defines "*fair market valu*e, in nontechnical usage, a term that is generally synonymous with the contemporary usage of *market value*,"

[57] According to *The Appraisal of Real Estate* "*Third Canadian Edition*, 2010," [t]he land residual technique is a method of estimating land value in which the net operating income attributable to the land is isolated and capitalized to produce an indication of the land's contribution to the total property," [p. 16.12] which differs from the steps involved in "subdivision development analysis." See *Subdivision Valuation*, 2nd ed., © 2017, Appraisal Institute, Chapter 11 (Land Value Using the Subdivision Development Method).

[58] In Canada, an expert witness that "provides evidence that was useless" to the client and to the court (arbitrator or arbitral panel) is entitled to "expert witness immunity." (See *The 6th Line Mofos Limited v. Stewart* 2022 ONSC 520). In the United States, some jurisdictions do not permit a party to sue its own expert witness. In Florida, an expert in an arbitration hearing may not rely on the statutory immunity granted to arbitrators and may be sued for negligence. Fla. Stat. §682.0 51 (2016) created statutory immunity for arbitrators, and immunity has never been expressly expanded to include experts. (Brian C. Willis, "Resolving Disputes By Expert Determination: What Happens When Parties Select Appraisers, Accountants, Or Other Technical Experts To Decide Disputes,") *Florida Bar Journal*, Vol. 91, No. 7 July/Aug 2017, p. 35, https://www.floridabar.org/the-florida-bar-journal/resolving, accessed on 14 November 2023. In the United Kingdom, in the decision of the Supreme Court in *Jones v. Kaney*, [2011] UKSC 13, "expert witness immunity" was abolished for a party suing its own expert in a claim for negligence.

[59] Peter T. Christensen, "Averting Professional Liability Claims, Essential guidelines for appraisers serving as expert witnesses," *Right of Way* (November/December 2016): 24-27, https://www.liability.com/publications/2016/averting-professional-liability-claims.aspx, accessed on 20 November 2023.

neutral manner and in accordance with the arbitration agreement and arbitration act governing the geographic location of the demised premises. Depending on the jurisdiction in which the property is located, the complexity of the valuation issue(s) or the amount of rent in dispute, it may be appropriate for each party to have its own appraisal report independently reviewed by a qualified appraiser prior to the arbitration, and address any shortcomings warranting revisions to the appraisal report. A party's failure to have its own appraisal independently reviewed prior to acting upon it could prove to be a costly oversight.

Arbitrators exercise wide discretion as to how they weigh appraisal evidence, and appraisal evidence that is credible will carry more weight. Valuations at the extremes do little to enhance the credibility of the appraisal profession. Arbitration awards are final and binding,[60] absent any extremely limited irregularities. Accordingly, each party should exercise due diligence in formulating an appropriate appraisal strategy in anticipation of a rent reset arbitration. Rent reset arbitrations can be costly, but an effective pre-arbitration appraisal strategy will shorten the duration of the arbitration and likely result in substantial cost savings to both parties.

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[60] "Arbitrators are judges chosen by the parties to decide the matters submitted to them, finally and without appeal. As a mode of settling disputes, it should receive every encouragement from courts of equity. If the award is within the submission, and contains the honest decision of the arbitrators, after a full and fair hearing of the parties, a court of equity will not set it aside for error, either in law or fact." *Burchell v. Marsh*, 58 US 344 (1854) 17 How.344.

AUTHORS' DECLARATIONS AND ESSENTIAL ETHICAL COMPLIANCES

Author's Contributions (in accordance with ICMJE criteria for authorship)

This article is 100% contributed by the sole author. He conceived and designed the research or analysis, collected the data, contributed to data analysis & interpretation, wrote the article, performed critical revision of the article/paper, edited the article, and supervised and administered the field work.

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Research involving human bodies or organs or tissues (Helsinki Declaration)

The author(s) solemnly declare(s) that this research has not involved any human subject (body or organs) for experimentation. It was not a clinical research. The contexts of human population/participation were only indirectly covered through literature review. Therefore, an Ethical Clearance (from a Committee or Authority) or ethical obligation of Helsinki Declaration does not apply in cases of this study or written work.

Research involving animals (ARRIVE Checklist)

The author(s) solemnly declare(s) that this research has not involved any animal subject (body or organs) for experimentation. The research was not based on laboratory experiment involving any kind of animal. Some contexts of animals are also indirectly covered through literature review. Therefore, an Ethical Clearance (from a Committee or Authority) does not apply in cases of this study or written work.

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The author(s) solemnly declare(s) that this research has not involved Indigenous Peoples as participants or respondents, with the documentation of their Indigenous Knowledge. Some other contexts, if any, of Indigenous Peoples or Indigenous Knowledge are only indirectly covered through literature review. An Ethical Clearance 'to conduct research on indigenous peoples' Indigenous knowledge is also not relevant. Therefore, an Ethical Clearance (from a Committee or Authority) or prior informed consent (PIC) of the respondents or Self-Declaration in this regard does not apply in cases of this study or written work.

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(Optional) Research Involving Local Community Participants (Non-Indigenous)

The author(s) solemnly declare(s) that this research has not involved local community participants or respondents belonging to non-Indigenous peoples. This study did not involve any child in any form directly. The contexts of different humans, people, populations, men/women/children and ethnic people are also indirectly covered through literature review. Therefore, an Ethical Clearance (from a Committee or Authority) or prior informed consent (PIC) of the respondents or Self-Declaration in this regard does not apply in cases of this study or written work.

(Optional) PRISMA (Preferred Reporting Items for Systematic Reviews and Meta-Analyses)

The author(s) has/have NOT complied with PRISMA standards. It is not relevant in case of this study or written work.

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